No. 301

In the Supreme Court of the United States

October Term, 1944

THE [illegible]

[illegible]

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE [illegible] CIRCUIT

BRIEF FOR [illegible]

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 201

THE UNITED GAS IMPROVEMENT COMPANY,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the United States Board of Tax Appeals (R. 95–110) is reported in 47 B. T. A. 715. The opinion of the Circuit Court of Appeals (R. 147–155) is reported in 142 F. 2d 216.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 31, 1944 (R. 155–156). The petition for a writ of certiorari was filed June 28, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer held all of the preferred and 98.97% of the common stock of a corporation which was reorganized under Section 77B of the Bankruptcy Act. The taxpayer was also a bondholder and a general creditor and had guaranteed certain bonds. As a result of the reorganization proceedings, the taxpayer received the entire new issue of the common stock, the indebtedness to the taxpayer was eliminated, the guaranteed bonds were paid, and the unguaranteed bonds were exchanged for new bonds. Does Section 112 (b) (3) of the Revenue Act of 1936 prevent the recognition of the taxpayer's alleged loss?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra,* pp. 11–14.

STATEMENT

The case was heard before the Board of Tax Appeals on a stipulation of facts. The petitioner, The United Gas Improvement Company (hereinafter referred to as the taxpayer), is a corporation organized under the laws of the Commonwealth of Pennsylvania, with its principal office in Philadelphia, Pennsylvania (Stip. par. 1, R. 15). Just prior to the July 5, 1935, reorganization proceedings involved in this case, and hereinafter described, under Section 77B of the Bankruptcy Act, the taxpayer was the substantial

owner through the ownership of nearly all the stock, common and preferred, of the Nashville Gas and Heating Company, a corporation organized under the laws of the State of Tennessee. At the time the above-mentioned bankruptcy proceedings were commenced, the taxpayer was the holder of 15,834.4 shares of a total issue of 16,000 shares, or 98.97% of the common stock of the Nashville Gas and Heating Company, which had a par value of $100 per share. (Stip. pars. 2, 4, R. 15; Stip. par. 29, R. 20.) The taxpayer also was the holder of the entire issue of 8,000 shares of preferred stock of that company with a par value of $100 per share (Stip. par. 4, R. 15; Stip. par. 29, R. 20). The Nashville Gas and Heating Company had outstanding, besides the above-mentioned stock, $1,954,000 par value first mortgage bonds, which were guaranteed as to principal and interest by the taxpayer. The taxpayer held $37,000 par value of these bonds. (Stip. par. 5, R. 15; Stip. par. 9, R. 16; Stip. par. 29, R. 20.) The Nashville Gas and Heating Company also had outstanding $775,000 par value of first mortgage bonds not guaranted by the taxpayer. Of these latter bonds, the taxpayer itself held bonds of $40,000 par value. (Stip. par. 29, R. 20.) In addition, the taxpayer was heavily interested in the Nashville Gas and Heating Company as a general creditor to the extent of $522,225 for advances on which interest had been paid

to June 30, 1934 (Stip. par. 22, R. 19). As previously mentioned, the taxpayer was also contingently interested in the Nashville Gas and Heating Company by virtue of the taxpayer's guarantee upon $1,954,000 of the bonds of the latter company.

On December 31, 1936, before the execution of the reorganization proceedings under Section 77B of the Bankruptcy Act, hereinafter described, the balance sheet of the Nashville Gas and Heating Company (Stip. Schedule 1, R. 33–34) showed assets of $6,294,854.15, and liabilities, apart from the capital stock account, of $4,035,297.51, leaving a book value of the common and preferred capital stock of $2,259,556.64.

On July 5, 1935, the Nashville Gas and Heating Company filed in the United States District Court for the Middle District of Tennessee a petition for the reorganization of the corporation under Section 77B of the Bankruptcy Act (Bankruptcy Act, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 7, 1934, c. 424, 48 Stat. 911, Section 1), setting forth that the company was a debtor unable to meet its debts as they matured and that it was desirous of effecting a plan of reorganization (Stip. par. 30, R. 20; Schedule 6, par. 8, R. 43). On September 20, 1935, a plan of reorganization was filed with the court, but never adopted, due to objections of certain owners of the aforesaid unguaranteed bonds (Stip. par. 33, 34, R. 21;

Schedule 7, R. 55–64). On March 16, 1936, a new "Plan of Reorganization" was filed with the court (Stip. par. 35, R. 21; Schedule 9, R. 67–76) and approved by the court on June 11, 1937 (Stip. par. 36, R. 22; Schedule 10, R. 77–86), with a modification, immaterial in this case, on June 21, 1937 (Stip. par. 37, R. 22).

The plan as adopted and approved (Schedule 9, R. 68–76; Schedule 10, R. 77–86) was in substance as follows:

1. The holders of the common stock (98.97% held by the taxpayer) and of the preferred stock (100% held by the taxpayer) would receive nothing for their shares (R. 71), and the same were to be cancelled (Schedule 10, par. 11 (c), R. 84).

2. The holders of the first mortgage bonds guaranteed by the taxpayer were to receive the face value thereof with interest to May 1, 1937, the amount necessary to pay the same to be paid by the taxpayer under its guarantee (Schedule 9, par. IV (a), (c), R. 69, 70).

3. The holders of the unguaranteed first mortgage bonds were to receive dollar for dollar new first mortgage bonds due in 1951 (Schedule 9, par. IV (b), R. 70).

4. The loan of $522,225 by the taxpayer to the Nashville Gas and Heating Company was to be cancelled (Schedule 9, par. IV (c), R. 71).

5. All other claims of creditors were to be paid in full in cash (Schedule 9, par. II, R. 69).

6. On the payment by the taxpayer under its guarantee to the trustee of the bondholders of the sum necessary to satisfy the first mortgage bonds guaranteed by it, the taxpayer was to receive the entire issue of the new common stock of the Nashville Gas and Heating Company, *viz.*, 20,000 shares of common stock of a par value of $100 per share (Schedule 9, par. IV (c), R. 70).

Upon the approval of the plan by the court on June 11, 1937, the Nashville Gas and Heating Company wrote down its plant, property and equipment accounts by the sum of $1,665,785.33, with the approval of the Railroad and Public Utilities Commission of the State of Tennessee (Supp. Stip. par. 2, R. 94).

The plan as approved was carried out. On April 23, 1937, the taxpayer paid to the trustee for the bondholders $1,964,925, the sum necessary to pay the bonds guaranteed by it, except those held by the taxpayer, with the interest thereon, and such sum was duly disbursed to the bondholders (Stip. par. 38, R. 22).

On or about August 25, 1937, the Nashville Gas and Heating Company issued to the taxpayer 20,000 shares of its new common stock (Stip. par. 42, R. 23). On or about the same date, the company also issued its new first mortgage bonds for the face amount of $775,000 to be delivered to the former owners of the old unguaranteed first mort-

gage bonds of the same amount (Stip. par. 41, R. 23).

On April 11, 1938, the United States District Court for the Middle District of Tennessee entered its final decree determining that the plan of reorganization had in all respects been fully executed and carried out and the proceedings were to be declared terminated (Stip. Schedule 12, R. 90–93).

On December 31, 1937, when the reorganization plan was consummated, except for the final approval of the court, the balance sheet of the Nashville Gas and Heating Company (Stip. Schedule 1, R. 35–36) showed assets of $4,578,907.89, and liabilities, apart from the capital stock account, of $1,268,629.64, leaving a book value for the common stock of $3,310,278.25. This was after the plant, property and equipment accounts had been written down, June 11, 1937, by the amount of $1,665,785.33.

In its income and excess profits tax return for the year 1937, the taxpayer claimed deductions on account of its alleged loss in its investment in the old common and preferred shares of the Nashville Gas and Heating Company and on account of the cancelled debt of $522,225 (R. 103). The Commissioner disallowed the deductions on the ground that there was a reorganization of the company within the meaning of Section 112 (g)

of the Revenue Act of 1936, and he accordingly assessed a deficiency (R. 104). The Board of Tax Appeals sustained the action of the Commissioner (R. 95–111), and the court below affirmed (R. 155).

ARGUMENT

The court below held, correctly, we submit, that there was a recapitalization (*Helvering* v. *Southwest Corp.*, 315 U. S. 194, 202) and hence a reorganization under Section 112 (g) of the Revenue Act of 1936 (Appendix, *infra*, pp. 11–12); also an exchange of securities for securities under subdivision (b) (3) of Section 112 (Appendix, *infra*, p. 11) so that no loss could be recognized on the transaction. The taxpayer admits there was a reorganization (Pet. 11), but contends that there was no exchange, citing in support of that contention *Fairbanks* v. *United States*, 306 U. S. 436; *Helvering* v. *Flaccus Leather Co.*, 313 U. S. 247; and Article 112 (a)–1 of Treasury Regulations 94 (Appendix, *infra*, p. 12). However, the *Fairbanks* and *Flaccus* cases are not in point; they relate to different taxable situations and statutory provisions, and the holdings there do not conflict with the decision here. Nor is the provision of the regulations referred to at variance with the instant decision. That provision is to the effect that to constitute an exchange within the meaning of Section 112 (b) (1)–(5), inclusive, the transaction must be a reciprocal transfer of

property; and here there was certainly such a transfer. The Board of Tax Appeals so found (R. 109), and that finding being based upon substantial evidence was properly upheld by the court below (R. 154). *Wilmington Co.* v. *Helvering*, 316 U. S. 164; *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231.

The taxpayer urges (Pet. 7, 12) that there is a conflict with *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, but clearly no such conflict exists. That case involved the question whether a certain reorganization plan was "fair and equitable" within the meaning of Section 77B of the Bankruptcy Act, and the opinion does not suggest that a transaction such as here involved could not be considered as an exchange within the purview of Section 112 (b) (3).

The taxpayer also contends (Pet. 13–15) that the decree of the reorganization court was binding upon everybody and that the Board of Tax Appeals and the court below, in passing upon the tax consequences of the plan, had no authority to disregard the provisions therein to the effect that nothing should be received by the taxpayer in exchange for its stock and claim. *Local Loan Co.* v. *Hunt*, 292 U. S. 234, relied upon by the taxpayer (Pet. 13), does not support this contention. It holds that a court of bankruptcy has jurisdiction by ancillary proceedings to enforce an order of discharge by enjoining the prosecution of suits

brought against the debtor; and is not out of harmony with the view taken by the Board of Tax Appeals and Circuit Court of Appeals (R. 109, 154) that, irrespective of the wording of the plan, the Commissioner properly looked through form to substance and applied the familiar rule (*Helvering* v. *Limestone Co.*, 315 U. S. 179, 184–185) that a single plan or scheme may not be broken up into separate steps for tax purposes.

Here the taxpayer's money is still tied up in the same kind of property as that in which it was originally invested (R. 152–153), and it has not been shown that taxpayer closed out a losing venture (*Helvering* v. *Cement Investors*, 316 U. S. 527, 533). Hence, there is no adequate basis for the claimed deduction.

CONCLUSION

The decision is correct and there is no conflict. Accordingly, the petition should be denied.

Respectfully submitted.

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